

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE

SOUTHERN DISTRICT OF GEORGIA
Statesboro Division

IN RE:)	Chapter 7 Case
)	Number <u>98-60246</u>
HAMPTON COUNTY WAREHOUSES, INC.,)	
_____)	
_____Debtor.)	
_____)	
)	
EARL BEASLEY,)	FILED
COWART FARMS,)	at 3 O'clock & 10 min. P.M.
JAMES COWART,)	Date" 3-24-00
GRINER FARMS,)	
WILLIAM J. LANE, JR.,)	
MIKE E.LEE,)	
JOHNNY B. McMILLAN,)	
)	
_____Claimants,)	
)	
vs.)	
)	
ANNE R. MOORE,)	
)	
Chapter 7 Trustee.)	
_____)	

ORDER

Claimants Earl Beasley, Cowart Farms, James Cowart, Griner Farms, William J. Lane, Jr., Johnny B. McMillan, and Mike E. Lee (together referred to as "Claimants," singly as "Claimant" or by name) have each filed a general unsecured claim in the chapter 7

bankruptcy case of Hampton County Warehouses, Inc. ("Debtor"). Anne R. Moore, trustee of Debtor's bankruptcy estate ("Trustee"), objects to the claims on the grounds that they should be filed against a different entity, Sea Island Cotton Trading, Inc., debtor in Chapter 7 case No. 98-60161 also pending in this court. Mr. Lee's claim is disallowed. The other six claims are allowed.

With regard to Claimants Mr. Beasley, Cowart Farms, Mr. James Cowart, Griner Farms, Mr. Lane, and Mr. McMillan, the facts of this case are as follows. David Prosser was the President and sole stockholder of both Hampton County Warehouses, Inc. ("Debtor") and Sea Island Cotton Trading, Inc. ("Sea Island"). The two corporations handled complementary aspects of the cotton commodity business: Debtor stored cotton, and Sea Island brokered cotton. David Prosser controlled and actively managed both. David Prosser, Debtor and Sea Island are all in bankruptcy.

Debtor, a Georgia corporation, owned and operated a warehouse in Estill County, South Carolina, which was licensed to operate under the laws of the State of South Carolina and began doing so in 1997. Claimants are all cotton farmers who stored their cotton bales with Debtor. Once their cotton had been baled and warehoused, Claimants monitored the fluctuating commodity price of cotton, watching for a good price to sell. When the Claimant's best

anticipated price for cotton was reached, the Claimant would notify his cotton broker, here Sea Island, to sell.

Sometimes a Claimant needed cash before the price of cotton reached an acceptable sale price. Some of the Claimants accepted "advances" from Sea Island. The advances were never for the full value of the cotton stored by each Claimant with Debtor. The nature of the "advances" is undetermined, whether they were short-term unsecured loans, secured loans, payments contingent on Sea Island receiving the Claimant's electronic warehouse receipts, or some other type of transaction. As used in this Order, the term "advance" refers to payments made by Sea Island to Claimants but connotes no particular type of financial transaction.

When the cotton bales were deposited with Debtor, Debtor issued electronic warehouse receipts ("EWR"). EWR are electronic records in a central filing system. Debtor did not print any paper documents.¹ Cotton is sold by exchanging the warehouse receipts for the purchase price. At an undetermined point, the EWR were placed

¹ S.C. law now requires that, "[i]f a warehouseman elects to utilize electronic warehouse receipts, he must provide written notice to the depositor that the EWR have been issued to the depositor, the numbers of the EWR so issued and that the receipts are being held on his behalf and cannot be transferred to any other party without the depositor's written consent," and makes failure to do so a felony. S.C.Code Ann. § 39-22-80, 39-22-90. This was not in effect at the time Debtor received the cotton bales at issue.

in the name of Sea Island. With the EWR in its name, Sea Island could and did sell the cotton bales that Claimants had stored with Debtor.

Claimants only learned that their cotton had been sold after Sea Island filed for bankruptcy on April 1, 1998. Sea Island made no payments, other than advances, to Claimants. In some instances checks payable to claimants were not honored by the payor bank. They bounced. No one disputes that Claimants are owed the unpaid value of their cotton. The issue is whether Debtor was authorized to transfer the EWR to Sea Island. If Debtor legitimately transferred the EWR, then Claimants' claims would be against Sea Island. If the transfers were not authorized, then Debtor bears responsibility for Claimants' losses and the claims are properly filed against Debtor's bankruptcy estate.

South Carolina created the Warehouse Receipts Guaranty Fund ("Guaranty Fund") to guard against this type of loss. S.C.Code Ann. §§ 39-22-150 & 39-22-15. The Guaranty Fund is administered by the South Carolina Department of Agriculture ("Dept. of Agriculture"). *Id.*² Claimants each submitted claim forms to the

² South Carolina Code, Title 39, Chapter 22, State Warehouse System, refers generally to "the department" throughout its sections and subsections, but never defines "the department" as the State Department of Agriculture. However, Chapter 22 was enacted in 1990

Dept. of Agriculture, stating the amount (if any) of the advance received from Sea Island and seeking reimbursement of the remainder outstanding. The Dept. of Agriculture denied the claims. It believed that the Guaranty Fund was intended to reimburse rightful holders of warehouse receipts and that Sea Island was the rightful holder. This belief was based on an assumption, that Sea Island would have required access to EWR in exchange for giving advances, so receipt of an advance was evidence that the Claimant authorized the transfer of his EWR to Sea Island. Claimants have now filed claims against Debtor's estate for the losses denied by the Guaranty Fund. Claims by other farmers who lost cotton stored with Debtor were accepted by the Dept. of Agriculture and paid from the Guaranty Fund. As a condition of payment, these farmers subrogated their claims to the Dept. of Agriculture. The Dept. of Agriculture has filed a proof of claim in Debtor's bankruptcy for the total of these subrogated claims.

to replace the now-repealed Chapter 21, and § 39-21-10 was titled, "Duties of former cotton warehouse system conferred on Department of Agriculture," and read, "All the powers, duties and privileges of the department formerly known and designated as the cotton warehouse system for the State of South Carolina are conferred upon the State Department of Agriculture." The testimony of John Barnes of the South Carolina Department of Agriculture establishes that the State Warehouse System and the Warehouse Guaranty Fund are administered by that agency, as does the promulgation of applicable regulations by that agency, S.C.Code Ann. Regs. 5-490 et seq.

Trustee believes Claimants should file their claims in Sea Island's bankruptcy. Trustee asks the court to adopt the reasoning of the Dept. of Agriculture, declare that Debtor legally transferred the EWR, and deny Claimants' claims against Debtor's bankruptcy estate. Claimants deny ever authorizing the transfer of their EWR to Sea Island, deny authorizing Sea Island to sell their cotton, and deny that access to the EWR was consideration for the advances. They maintain that Debtor wrongfully transferred their EWR, and they seek to claim against Debtor's bankruptcy estate.

Mr. Lee is in a different situation than that just described. Mr. Lee did authorize Sea Island to sell his cotton. Sea Island sold the cotton and gave Mr. Lee a check for the full amount due. However, the check was returned for insufficient funds. The Dept. of Agriculture denied Mr. Lee's claim because Debtor had been authorized to transfer Mr. Lee's EWR, and Trustee objects to Mr. Lee's claim against Debtor for the same reason.

The Court has jurisdiction to hear this matter as a core bankruptcy proceeding under 28 U.S.C. § 157(b)(2)(A) & (B) and 28 U.S.C. § 1334 (1994). Warehouses and warehouse receipts are governed by federal and state law and regulations which are necessarily dispositive in this proceeding. United States Warehouse Act, 7 U.S.C. § 241 et seq.; UCC Warehouse Receipts, etc. S.C.Code

Ann. § 36-7-101 et seq.; State Warehouse System, S.C.Code Ann. § 39-22-10 et seq.; Agriculture Department, Warehouse System, 23 S.C. Code Ann. Regs. 5-490 to 5-497; Grogan v. Garner, 111 S.Ct. 654, 657, 498 U.S. 279, 283, 112 L.Ed.2d 755 (1991) (validity of a claim in bankruptcy is determined by state or federal nonbankruptcy law).

A filed proof of claim is prima facie evidence of the validity of the claim. 11 U.S.C. § 502(a), Fed. R. Bankr. P. 3001(f). Upon objection to the claim, the burden is on the objector, here Trustee, to come forth with sufficient evidence to place the claim in issue. Once the claim is placed in issue, the claimant must establish the debt by a preponderance of the evidence. Grogan v. Garner, 111 S.Ct. at 659; In re VTN, Inc., 69 B.R. 1005, 1008 (Bkrtcy.S.D.Fla. 1987).

Trustee placed the claims in issue by testimony establishing that the Dept. of Agriculture denied the identical claims on the grounds that Debtor's transfer of the EWR to Sea Island was lawful. However, the preponderance of the evidence shows that the transfer of the EWR of six of the Claimants was not lawful. This determination rests entirely on South Carolina statute and Dept. of Agriculture regulation. Mr. Lee failed to prove that Debtor wrongfully transferred his EWR to Sea Island.

As a licensee of the state of South Carolina, Debtor is

subject to South Carolina State Warehouse Systems law. S.C.Code Ann. § 39-22-10 et seq.; Grogan v. Garner, 111 S.Ct. at 657. The South Carolina State Warehouse Systems law explicitly incorporates pertinent federal regulations governing EWR. S.C.Code Ann. § 39-22-80. It also charges the Dept. of Agriculture with promulgating regulations to implement the State Warehouse System. S.C.Code Ann. § 39-22-30;³ S.C.Code Ann. Regs. 5-490 et seq. In South Carolina, a regulation has the force of law if it is reasonably related to the purpose of the enabling legislation and if any variation from that legislation is no more than a natural amplification of the law. McNickel's Inc. v. South Carolina Dept. of Revenue, 331 S.C. 629, 503 S.E.2d 723 (S.C. 1998) (citing Hunter & Walden Co. v. South Carolina State Licensing Bd. for Contractors, 272 S.C. 211, 251 S.E.2d 186 (1978); Goodman v. City of Columbia, 318 S.C. 488, 458 S.E.2d 531 (1995) (quoting Faile v. S.C. Employment Security Commission, 267 S.C. 536, 230 S.E.2d 219 (1976))).

Dept. of Agriculture Regulation 5-493(G) resolves the issue of whether Sea Island's advance payments to Claimants authorized Debtor to transfer the EWR. S.C.Code Ann. Reg. 5-493(G).

³ S.C.Code § 39-22-30. Department to promulgate regulations. The department shall promulgate regulations to implement the provisions of this chapter.

This regulation was last reissued in 1994, and therefore was in effect at all times Debtor was in business. Id.

S.C.Code Reg. 5-493. Receipts

G. A warehouse receipt shall not be issued in the name of the purchaser of any commodity being purchased on a deferred-price, delayed payment or similar credit-type sale arrangement until the seller has received payment for the commodity in full unless he has executed the affidavit relinquishing title and ownership to the buyer and forfeiting his rights under the Dealers and Handlers Guaranty Fund and has fully complied with the requirements set out in Section 39-22-200.

S.C. Code § 39-22-200 provides:

S.C. Code § 39-22-200. Issuance of receipts; receipts not to be issued in name of warehouse; exceptions.

A state warehouse receipt must be issued by the warehouseman to a person storing commodities who requests it. If no receipt is issued to the storing party directly, one must be written to show ownership and held at the warehouse office properly locked and secured. No receipt may be issued in the name of the storing warehouse, or its owners, on commodities being purchased by the warehouse until the commodity has been paid for in full, even if a contract has been executed establishing that the title to the commodity has passed to the warehouse or its owners unless the buyer and seller execute an affidavit within the contract stating that the seller conveys title and ownership of the commodity and forfeits all of his rights under the Dealer and Handler Guaranty Fund. The affidavit must be in bold print on the face of the contract and must further state that the

seller has read the contract in full, understands it, and waives all rights to contest his knowledge of any part of the contract. Those provisions do not reduce the responsibility of the warehouseman to keep proper records as required by Section 39-22-190.

Regulation 5-493(G) is reasonably related to State Warehouse System law, specifically S.C.Code § 39-22-200, and it varies from that statute only as natural amplification. S.C.Code Ann. §§ 39-22-10 et seq. and Reg. 5-493(G); McNickel's Inc., 503 S.E.2d 723; Hunter & Walden, 251 S.E.2d 186. The regulation's definitive statement that Debtor was not authorized to transfer the EWR therefore carries the force of law.⁴ Id.

The word "commodity" in regulation 5-493(G) specifically includes "cotton." S.C.Code Ann. Regs. 5-490(G)(1) & 5-493(G). The

⁴ South Carolina case law notes that the construction of a statute by the agency charged with its administration must be accorded the most respectful consideration and should not be overruled without cogent reasons. Glover v. Suitt Construction Co., 318 S.C. 465, 469, 458 S.E.2d 535, 537 (S.C. 1995); Faile, 230 S.E. 2d at 221-22. The Dept. of Agriculture set out its construction of State Warehouse System law in its applicable regulations. Although an employee of the Dept. of Agriculture testified at the April 23, 1999 hearing, no reference was made to regulations, either as to following them or as to interpreting them other than as written. No cogent reasons to overrule the clear mandate of the Dept. of Agriculture were offered at the hearing or by post-hearing brief. Therefore, the Court accords respectful consideration to the plain language of regulations promulgated by the agency charged with administering the South Carolina State Warehouse System law.

advances paid by Sea Island to Claimants fall within the description, "deferred-price, delayed payment or similar credit-type sale arrangement." S.C.Code Ann. Reg. 5-493(G). Debtor would have been authorized to transfer the EWR to Sea Island if Claimants had received payment in full for all their cotton. Id. However, Claimants did not receive payment in full. Debtor would also have been authorized to transfer the EWR if Claimants had executed affidavits relinquishing title and ownership of the cotton bales to Sea Island and forfeiting their rights under the Guaranty Fund.⁵ Id. No such affidavits were testified to or offered into evidence. Trustee's Exhibit 12, a "Contract for the Purchase and Sale of Cotton Gin Direct" between Sea Island and Mr. McMillan, does not transfer title or ownership (Mr. McMillan warrants that he has "full

⁵ Reg. 5-493(G) and § 39-22-200 both name the Dealers and Handlers Guaranty Fund. This fund is established under S.C.Code Ann. § 46-41-200 et seq., and appears to be similar to the Warehouse Receipts Guaranty Fund. Where the Warehouse Receipts Guaranty Fund concerns non-perishable farm products, the Dealers and Handlers Guaranty Fund covers feed grain and oil seeds, except cotton seeds. Reg. 5-493(G) may have been intended to reference the Warehouse Receipts Guaranty Fund. Within the same Regulations Article 13, Warehouse System, "commodity" is defined as "cotton" (5-490(G)(1)) and another regulation (5-497, Procedures for filing claims) does name the Warehouse Receipts Guaranty Fund. Within the same Statute Chapter 22, State Warehouse Systems, as § 39-22-200 is § 39-22-150, which establishes a fund to guarantee state warehouse receipts. Since neither Guaranty Fund is mentioned in Trustee's Exhibit 12, the identity of the Guaranty Fund referenced by Reg. 5-493(G) does not affect this Order.

right and title" but does not relinquish it) and makes no mention of the Guaranty Fund. Moreover, each Claimant except Mr. Lee testified that he had not released his cotton for sale and had not authorized transfer of his EWR. Since neither condition for issuing a warehouse receipt in Sea Island's name was met, Regulation 5-493(G) prohibited transfer of these Claimants' EWR.

Claimants' claims are addressed individually as follows.

1. EARL BEASLEY: Mr. Beasley had a business arrangement with his step-grandson, Mr. Vickrey, who testified in this matter. Mr. Beasley owned the land, Mr. Vickrey did the work, and they split the cotton fifty-fifty. Mr. Beasley and Mr. Vickrey originally had one agreement with Sea Island to sell all their cotton. However, they cancelled that contract and executed separate contracts, because Mr. Vickrey wanted payment in 1997 and Mr. Beasley wanted payment in 1998. Mr. Vickrey received payment, but Mr. Beasley remains unpaid. Mr. Beasley received a check from Sea Island for \$10,000 as an advance; the check was returned for insufficient funds. Mr. Beasley submitted a claim against the Guaranty Fund, which was denied. The Dept. of Agriculture concluded that Mr. Beasley and Mr. Vickrey were a partnership, that the partnership had agreed to sell its cotton to Sea Island, and that the EWR were therefore lawfully transferred. The Dept. of Agriculture is

incorrect. The receipts were not lawfully transferred. Whether a contract to sell was signed by Mr. Beasley and Mr. Vickrey as a partnership, or whether two contracts were signed by them as individuals, a contract to sell does not authorize transfer of EWR according to the Dept. of Agriculture's own Regulation 5-493(G). Neither do advances, payment of less than one hundred percent. Trustee's objection to Mr. Beasley's claim based on the Dept. of Agriculture's rationale is overruled.

2. COWART FARMS: Cowart Farms received advance payment from Sea Island. Cowart Farms submitted a claim against the Guaranty Fund for the unpaid portion of its cotton. It was denied because the Dept. of Agriculture believed that advance payments were evidence of an agreement to sell, and that an agreement to sell was evidence of lawful transfer of EWR. Mr. Anthony Cowart, of Cowart Farms, did testify under cross-examination that accepting an advance from a broker customarily signifies that that broker will later sell the cotton. However, the Dept. of Agriculture's own regulation states that an agreement to sell in the future does not authorize immediate transfer of receipts. Trustee's objection to Cowart Farms' claim is overruled.

3. JAMES COWART: Mr. Cowart had stored 529 bales with Debtor, and had authorized Sea Island to sell 124 of them. Without

Mr. Cowart's authorization, Sea Island sold the other 405 bales a few days prior to filing for bankruptcy. Mr. Cowart filed a claim for 405 bales against the Guaranty Fund. According to the testimony of Mr. Barnes, the Dept. of Agriculture reasoned that because the 405 bales of cotton had been sold, their receipts had been properly transferred. Obviously this reasoning could not justify the Dept. of Agriculture's position. Although he may have intended to state that authorizing the sale of 124 bales was interpreted as authorizing the transfer of the EWR for all the bales, Regulation 5-493(G) provides otherwise. Trustee's objection to Mr. James Cowart's claim is overruled.

4. GRINER FARMS: Griner Farms received an eighty percent advance from Sea Island, and later filed a claim for twenty percent of its bales (72 of 358) against the Guaranty Fund. The Dept. of Agriculture interpreted the advance payment as evidence of lawful transfer of Griner Farms' EWR and denied the claim. The Dept. of Agriculture was again mistaken, and no valid objection to Griner Farms' claim exists on this basis.

5. WILLIAM J. LANE, JR.: Mr. Lane did sell some of his cotton. He claimed only the bales that were not authorized for sale, less advances received from Sea Island. He testified that warehouse receipts were never mentioned as part of the "advance"

transaction, that he never signed an agreement with Sea Island, and that he never authorized his EWR to be in anyone else's name, written or electronically. The Dept. of Agriculture denied the claim because Mr. Lane's advance payments were erroneously viewed as evidence of lawful transfer of his EWR. Trustee's objection to Mr. Lane's claim on this basis is also overruled.

6. JOHNNY B. McMILLAN: Mr. McMillan had a contract for sale of all of his cotton with Sea Island, received an eighty percent advance, and claimed the remaining twenty percent against the Guaranty Fund. The Dept. of Agriculture erroneously believed the EWR were properly transferred and denied his claim. Trustee's objection to Mr. McMillan's claim on this basis is also overruled.

7. MIKE E. LEE: Mr. Lee claims \$17,655.58 for 59 bales of cotton. Mr. Barnes of the Dept. of Agriculture testified that Mr. Lee stated that he had sold his cotton. Trustee's Exhibit 6, Mr. Lee's Response to Objection to Claim, includes Sea Island invoice no. 00933, which shows Mike Lee as the seller of 59 bales for a net invoice amount of \$17,655.58, and Sea Island check no. 22115, which is made out to Mike Lee in the amount of \$17,655.58. The Sea Island check is stamped "NSF" on its front, indicating that it was returned for insufficient funds. The Dept. of Agriculture believed that Mr. Lee would not have accepted and attempted to cash

the check unless he had authorized the sale of the 59 bales, and therefore Debtor had properly transferred the EWR on Mr. Lee's authorization. This testimony and evidence places Mr. Lee's claim in issue. Once in issue, the burden is on Mr. Lee to establish the debt by a preponderance of the evidence. Grogan v. Garner, 111 S.Ct. at 659. However, Mr. Lee did not testify to the circumstances of his claim. With no conflicting evidence, the preponderance of the evidence shows that Mr. Lee intended to sell his 59 bales and authorized the transfer of his EWR to Sea Island. Mr. Lee's claim may lie against Sea Island or David Prosser, but it is denied as to Debtor.

Except as to Mr. Lee, these determinations go against the testimony of Mr. John B. Barnes of the South Carolina Department of Agriculture, who testified in this proceeding as an expert witness. The Court is not bound by the statements of a witness whose testimony is shown to be patently erroneous. Mr. Barnes' testimony is disregarded for the following reasons.

1. Mr. Barnes testified that warehouse receipts are bearer instruments, with ownership shown by possession and not by having the owner's name on the receipt. In fact, a paper warehouse receipt may call for goods to be delivered to bearer or to the order

of a named person. S.C.Code Ann. § 36-7-104(1)(a). However, this proceeding concerns EWR, and EWR are required by law to be order instruments. 7 U.S.C. § 259(c)(1) (whether the issuing warehouse is licensed under federal or state law, "[EWR] shall state that the cotton shall be delivered to a specified person or to the order of the person"); S.C.Code Ann. § 39-22-80 (EWR are subject to pertinent federal regulation).

In addition to testifying that a warehouse receipt is a bearer instrument, transcript pages 1-19 and 1-22,⁶ Mr. Barnes expanded on that belief:

"Just in the last few year though the electronic receipts have come to be and with those we permitted the warehouses to issue those and most of our warehouses now do issue those but they were still charged with the same responsibility of being the holder on behalf of the farmer. And it is very difficult to understand about the - who's the holder of an electronic receipt when there is no physical document." (1-20)

The problem identified by Mr. Barnes is likely the very reason that EWR are required to be order, not bearer, instruments. 7 U.S.C. § 259(b)(1)(B); S.C.Code Ann. § 39-22-80. On cross-examination, Mr. Barnes repeated his confusion.

⁶All transcript page references are to the hearing on Trustee's claim objections held April 23, 1999.

"Q. Isn't it true that there's nothing on that form that appears when you pull it [an EWR] up on the computer that says it's a bearer document?" (1-47)

"A. I think that's right." (1-48)

2. Mr. Barnes testified that he was not an expert on the use of EWR and the central filing system. Mr. Barnes' testimony cannot be relied upon by me as to the functioning of the EWR system when it is qualified as follows.

"I'm pretty well computer illiterate but the way I understand that it works would be similar to your money machine with - with a pin number." (1-20)

"Q. When you want to look at an electronic warehouse receipt how do you look at it? One particular receipt?"

"A. Well, you would have to of course - have to be the holder of the receipt and then key in the information and pull it up. I mean I'm not a computer person so I - I wouldn't be able to do it. I can tell you that." (1-47)

3. Mr. Barnes relied on legal advice in determining whether the Dept. of Agriculture should allow or deny claims against the Guaranty Fund. As explained at the hearing, the legal advice did not take into consideration the state law and regulations which specifically govern the Guaranty Fund and the state warehouse system.

"the wording in the law is very specific that it only went to paying - guaranteeing that warehouse receipt to the receipt holder. And of course in this case none of the farmers were holding warehouse receipts.

And at that time we looked into the possibility, well, we - we definitely felt like the intent was there that, you know, if there was any fraudulent type activity that it was intended to cover that type of thing. ...So that if you weren't holding the receipts and it was because he improperly transferred the receipts then that would be a valid claim that we could pay from these funds." (1-23, 1-24)

The general purpose of warehouse receipt law is to guarantee the warehouse receipt to the receipt holder. Uniform Commercial Code - Documents of Title, S.C.Code Ann. § 36-7-101 et seq. However, the wording of the law pertinent to the Guaranty Fund specifically does not go to guaranteeing only the receipt holder.

S.C. Code § 39-22-150. Disposition of net revenues derived from operation of state warehouse system; additional fee on items for which warehouse receipts have been issued; use of funds generated by fee; guaranty fund; claims against fund.

[in pertinent part] The funds must be used to guarantee state warehouse receipts in excess of an amount recovered from the bonds required by this chapter, and to protect and reimburse depositors against losses as defined in Section 39-22-15.

S.C. Code § 39-22-15. "Loss" defined.

For purposes of this chapter, "loss" means any monetary loss over and beyond the amount protected by a warehouseman's bond sustained as a result of storing a commodity in a state-licensed warehouse including, but not limited to, any monetary loss over and beyond the amount protected by a warehouseman's bond sustained as a result of the warehouseman's bankruptcy, embezzlement, or fraud.

To paraphrase, the Guaranty Fund protects and reimburses Claimants

against losses sustained as a result of storing cotton in Debtor's state-licensed warehouse including, but not limited to, any monetary loss sustained as a result of Debtor's bankruptcy, embezzlement, or fraud. The purpose of the Guaranty Fund, and the applicable definition of loss, is not tied to the warehouse receipts. Since Debtor's transfer of EWR, except those of Mr. Lee, was not authorized according to Regulation 5-493(G), Claimants did sustain losses as a result of storing their cotton with Debtor.

Regulation 5-497, which states procedures for filing claims, does mention warehouse receipts.

Reg. 5-497. Procedures for filing claims.

B. The claimant must file his/her claim within sixty days of notification by the Department. The warehouse receipt(s) held by the claimant must be submitted along with the claim form.

Although Reg. 5-497(B) requires those warehouse receipt(s) which are held by a claimant to be submitted, this is not a condition of reimbursement. Clearly, bankruptcy, embezzlement or fraud could result in depositors being unable to produce warehouse receipts. How does one attach an EWR?

The Dept. of Agriculture needed to determine whether Claimants' losses were caused by Debtor. S.C.Code Ann. §§ 39-22-15 & 39-22-150. If Debtor's transfers of the EWR to Sea Island were

lawful, then Debtor was not the cause of loss. The nature of the EWR system precluded using warehouse receipts as evidence. To determine whether Debtor should have transferred Claimants' EWR to Sea Island, the Dept. of Agriculture looked to Sea Island's transactions with Claimants. The Dept. of Agriculture believed that any payment by Sea Island must have been consideration for transfer of all of Claimants' EWR. On this basis, the Dept. of Agriculture extrapolated from the existence of Sea Island's advances that Claimants had authorized Debtor to transfer all of their EWR to Sea Island and therefore Debtor acted lawfully. However, by the Dept. of Agriculture's own Regulation 5-493(G), Debtor should not have transferred the EWR to Sea Island. See S.C.Code Reg. 5-493. According to his own agency's regulation, Mr. Barnes could not look to Sea Island's advances to determine whether the transfer of EWR was legitimate. Yet that was the primary consideration in his decisions.

"Q. ...what was your criteria again once you had the information as to whether or not you would pay a claim or not?"

"A. Essentially whether or not there had been an agreement to sell the cotton. It - it - it boiled down to basically that fact alone because if there was an agreement to sell the cotton then we felt that the warehouse receipts were properly transferred. If there was no agreement to sell that cotton then we felt like that very likely the receipts were improperly transferred."

"Q. Now, are you talking about written agreements?"

"A. Not necessarily. No, ma'am."

"Q. Okay. What else could there be then to indicate that?"

"A. In some cases there wouldn't be any agreement. It would be the fact that they had received advance money on it. In many cases that - in most all of the cases that we denied there was money advanced. Either money advanced or written contracts, something to indicate that that cotton had been sold. Some cases it would be an invoice from Sea Island Cotton Trading that listed those particular bales on there and showing that - that it had been purchased by Sea Island Cotton Trading." (1-28)

"Q. Okay. And -and once more what was the criteria that y'all used to determine whether or not there had been - whether or not the guarantee fund should pay a claim?

"A. Whether or not the receipts had been lawfully transferred." (1-44)

Again, by Mr. Barnes' own agency's regulation, the receipts were not lawfully transferred. Mr. Barnes' primary criterion for denying the claims goes against Dept. of Agriculture regulation.

By brief, Claimants argued that their claims should be allowed under theories of bailee duties, warehouse duties, agency and respondeat superior. The transfer of six of the Claimants' EWR was governed by the plain language of statute and regulation. Mr. Lee did not rebut testimony that he had indeed authorized Debtor to transfer his EWR. Therefore, the additional arguments presented by Claimants' brief are not addressed.

Trustee argued by brief that the transfer of EWR was lawful according to common practice. Because EWR have only been in use for a few years, claimed "common practice" cannot overcome unambiguous regulatory language. Trustee also made an argument based on warehouse receipts being bearer paper. Since this is neither legally nor factually accurate for electronic receipts, this argument needs no further comment.

It is, therefore, ORDERED that the Trustee's objection to claims filed by Earl Beasley, Cowart Farms, James Cowart, Griner Farms, William J. Lane, Jr., and Johnny B. McMillan against the bankruptcy estate of Hampton County Warehouses, Inc., case no. 98-60246, are overruled, and as to the claim filed by Mike E. Lee is sustained striking Mr. Lee's claim in its entirety.

JOHN S. DALIS
CHIEF UNITED STATES BANKRUPTCY JUDGE

Dated at Augusta, Georgia

this 24th Day of March, 2000.